

# Senate Budget & Fiscal Review

Subcommittee No. 3

on

Health, Human Services, Labor, and Veterans Affairs



**Senator Wesley Chesbro, Chair**

**Senator Ray N. Haynes**

**Senator Deborah Ortiz**

.....  
**April 1, 2002**

**1:30 P.M.**

**ROOM 2040**

**(Diane Van Maren, Consultant)**  
.....

**Item**

**Description**

**4260**

**Department of Health Services, including issues regarding**

- Consent Calendar (issues as noted)
- Medi-Cal County Administration
- Medi-Cal Drug Program
- County Medical Services Program (CMSP)
- Hospital Funding Adjustments
- Medi-Cal Program Provider Rate Adjustments
- Other Medi-Cal Program Issues

**PLEASE NOTE: Please refer to the Senate Daily File for the dates and times of future Subcommittee hearings regarding the Department of Health Services.**

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## **I. 4260 Department of Health Services**

### **A. BACKGROUND**

#### **Purpose and Description of the Department**

The goals of the Department of Health Services (DHS) are to (1) promote an environment that contributes to human health and well-being; (2) assure the availability of equal access to comprehensive health services using public and private resources; (3) emphasize prevention-oriented health care programs; (4) promote the development of knowledge concerning the causes and cures of illness and the means of delivering health services to the public; and (5) assure economic expenditure of public funds to serve those persons with the greatest health care needs.

#### **Overall Budget of the Department**

The budget proposes expenditures of **\$29.9 billion (\$10.7 billion General Fund), or an increase of \$131.3 million (total funds) over the revised 2001-02 budget. Of this amount, \$29 billion is for local assistance and \$886.4 million is for state support.** State support expenditures include funds for 5,684 personnel-years.

<b>Summary of Expenditures</b>				
(dollars in thousands)	2001-02	2002-03	\$ Change	% Change
<b>Program Source</b>				
Health Care Services	\$28,865,867	\$28,975,176	\$109,309	0.3
Public and Environmental Health	908,733	934,666	25,933	2.8
State Mandated Local Programs	9,650	7,733	(1,917)	19.9
State Administration	2,175	2,159	(16)	0.7
Regional Projects and Adjustments	2,023	--	(2,023)	(100.0)
Totals, by Program Source	\$29,788,448	\$29,919,734	\$131,286	0.4
<b>Funding Source</b>				
General Fund	\$10,393,368	\$10,715,813	\$322,445	3.1
Federal Funds	16,630,424	16,495,558	(134,866)	(0.8)
Other Funds	2,764,656	2,708,363	(56,293)	2.0
Totals, by Fund	\$29,788,448	\$29,919,734	\$131,286	0.4

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### **Overview of the Budget for the Medi-Cal Program**

**The budget proposes local assistance expenditures of \$26.9 billion (\$10 billion General Fund). This reflects a *net* increase of \$367 million General Fund, or 3.8 percent, over the revised 2001-02 budget.** This net General Fund increase is attributable to several factors, including **(1)** eligibility simplification items adopted in the past legislative session, **(2)** adjustments to pharmaceutical expenditures, **(3)** proposed provider rate reductions, and **(4)** a reduction in the federal Medical Assistance Percentage (FMAP).

**A caseload of almost 6.5 million recipients is projected for 2002-03, which reflects an estimated increase of 304,100 recipients, or 4.9 percent.** This increased caseload is primarily due to the expansion of health care coverage to lower-income, uninsured working families and to the aged, blind and disabled populations.

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## **B. ITEMS FOR CONSENT (Items 1 through 9)**

### **1. Department of Health Services Reduction Proposal**

**Background and Governor's Proposed Budget:** The DHS is **proposing a reduction of about \$7.8 million General Fund from the budget.** This level of savings assumes the following:

- Delete the \$4 million (General Fund) set aside for the Quality Award Program to support financial rewards to employees of long-term care facilities providing high quality care to Medi-Cal recipients.
- Reduce by \$70,000 (General Fund) the contract for providing training to providers regarding sexually transmitted diseases and health education and counseling programs.
- Delete \$100,000 (General Fund) by using electronic transmission, in lieu of written publication, for the release of monthly statistics regarding California's mortality and morbidity.
- Reduce by almost \$1.5 million (General Fund) the contract with MEDSTAT to support the Management Information/Decision Support System. Any additional costs for the contract will be funded through Medi-Cal savings that MEDSTAT identifies.
- Reduce by \$60,000 (General Fund) to reflect savings from closing a Medi-Cal field office in San Jose.
- Reduce by \$290,000 (General Fund) to reflect the elimination of broad-based outreach and education activities targeting the general public regarding the availability of the New Born hearing Screening Program established in 1998. Resources would still be available to target high priority groups, such as families and pregnant women.
- Reduce by \$135,000 (General Fund) to reflect a reduction in travel time by the Office of Legal Services. Specifically, this proposal will require most institutional providers to appear in Sacramento or pay the state's cost to travel to other locations. The DHS states that the proposal does *not* require indigent persons to travel to Sacramento or to reimburse state costs for hearings closer to their place of residence.
- Eliminates General Fund support of \$120,000 which was used to conduct inspections of manufacturers of bunk beds and public facilities that use them.
- Eliminates a part-time Health Program Manager II position for savings of \$40,000 (General Fund).
- Transfers a Public Health Medical Officer III position from General Fund support to special fund support for savings of \$130,000.
- Reduces by \$1 million (General Fund) contracts in the information technology area and transfers the responsibility to existing DHS staff.
- Reduces by \$400,000 (General Fund) various costs in the information technology services section.

**The DHS notes that these reductions are necessary in order to not exceed available resources.**

Subcommittee staff has raised no issues with these proposed reductions in light of the present fiscal situation.

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## **2. Southern California Laboratory Needs Study**

***Background and Governor's Proposed Budget:*** Through a recent Section Letter, the DHS requested termination of the Southern California Laboratory Fire and Life Safety Renovation project which was adopted in the Budget Act of 1999 (authorized \$484,000 for preliminary plans and working drawings), and Budget Act of 2000 (authorized \$4 million for construction of the project). The original scope provided for upgrades to the mechanical, plumbing, and electrical systems, and to address ADA, seismic, and fire and life safety noncompliance issues.

The DHS is not certain that the laboratory will continue to meet its needs in the future. Specifically, the events of September 11, 2002 and the potential for increased bioterrorism activities may have an impact on workload and laboratory sufficiency.

**The budget proposes to delete the \$4 million (General Fund) to improve the laboratory and instead, proposes to spend \$150,000 (General Fund) for a study that will (1) identify DHS' current laboratory occupancy including existing program, workload, staff, and equipment, (2) identify future staff, workload, equipment and space requirements, including all assumptions for increased growth, (3) determine whether the existing laboratory can meet current and future workload needs, and (4) identify alternatives for meeting current and future laboratory needs.**

Subcommittee staff has raised no issues with this proposal.

## **3. Richmond Laboratory Complex-Phase III**

***Background and Governor's Proposed Budget:*** Development of the Richmond Laboratory campus is scheduled to occur in several phases. Phase III entails construction of a three-story office building. It is anticipated that the building will house approximately 850 staff. Site work will include utilities and parking for about 600 vehicles.

The project will consolidate all DHS East Bay Area office programs at the existing Richmond Campus immediately adjacent to the Phase I and II Laboratories. As such, the DHS contends that this will provide the unified environment necessary to maximize program and administrative efficiency, reduce the total square footage occupied in the East Bay area and meet DHS' current and future office and infrastructure needs in the most cost-effective manner.

**The budget proposes an increase of almost \$47.7 million (\$150,000 General Fund and \$47.5 million Public Building Construction Fund).**

Subcommittee staff has raised no issues with this proposal.

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#### **4. Center for Health Statistics—Processing of Backlog & Certified Copies**

***Background and Governor's Proposed Budget:*** Among other things, the Center for Health Statistics (CHS) is responsible for providing certified copies of vital records to individuals who need them, and also for registering every birth, death, fetal death, marriage, and dissolution that occurs in California.

In addition, the CHS is responsible for compiling and analyzing the statistical data gathered from vital records and providing crucial information to the DHS and to other government agencies for assessing the health status of Californians, tracking health trends, and closing health disparities.

The CHS receives and processes about 170,000 requests for certified copies of vital records and 50,000 amends per year. The number of certified copies processed has grown by 27 percent over the past five fiscal years, with an increase of about 10 percent in the last year alone.

According to the DHS, incoming workload averages 14,000 requests per month, not including requests that are received but rejected for lack of information or money. As of September 2001, the DHS states that there was a processing backlog of 60,041 requests. Based on the DHS' analysis, the backlog cannot be addressed given the current staffing levels.

The budget requests an increase of \$600,000 (Health Statistic Fund) to provide for temporary help to reduce the backlog.

Subcommittee staff has raised no issues regarding this proposal.

#### **5. Reengineering the Food Safety Program**

***Background and Governor's Proposed Budget:*** The budget proposes an increase of \$550,000 (Food Safety Fund) on a one-time only basis to complete a business process reengineering project for the Food Safety Program. This project will evaluate the program's business processes in order to develop, upgrade and consolidate the Food Safety Program's electronic communication, licensing, and data systems.

The DHS notes that the Food Safety Program's ability to rapidly communicate emergency information has been seriously challenged with the volume and frequency of emergencies. Recent examples include: illness outbreaks related to Hepatitis A in strawberries, Cyclospora in berries, and Salmonella in eggs and sprouts.

The existing communication and data system has been pieced together using outdated technology. Rapid communication is now available which requires state-of-the-art hardware and software. Therefore, a business process plan is needed in order to develop and implement an improved process.

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Subcommittee staff has raised no bones regarding this request.

## **6. Contract Adjustment for Licensing Functions in Los Angeles County**

***Background and Governor's Proposed Budget:*** The DHS contracts with LA County to perform facility surveys and complaint investigations. In fiscal year 2000-01, LA County maintained a total of 179 permanent positions to perform mandated facility surveys and investigations in the southern region of the state.

In the previous two fiscal years, state departments were granted personnel services cost of living increases equaling 7 percent. During this same period, LA County granted a 3.3 percent adjustment for its employees. However, this increase was not provided for in the annual baseline budget for contracts. As such, the DHS states that there is not adequate funding to pay for services in LA County. The DHS states that if funding is not granted, the number of surveys would have to be reduced and could endanger patients, or would require the DHS to hire additional state staff to accomplish these facility surveys.

**The budget is requesting an increase of \$417,000 (\$167,000 General Fund) to provide for an adjustment to the LA County contract.**

Subcommittee staff has raised no issues with the proposal.

## **7. Outcome and Assessment Information Set (OASIS) Workload**

***Background and Governor's Proposed Budget:*** OASIS is a patient assessment and care planning tool used by Home Health Agency (HHA) staff to gather information about the needs and care outcomes of the patients they serve. HHAs are required to report this information to the federal CMS. The DHS is required by the federal CMS to support the OASIS system as a condition of its federal contract in order to receive federal reimbursement through Medicaid and Medicare.

As such, the DHS states that there is permanent ongoing workload associated with providing training and clinical assistance to staff of the state's 800 licensed HHAs, and the Licensing and Certification Program's inspection staff located in 22 field offices around the state.

**The budget is requesting an increase of \$82,000 (federal funds) to permanently establish one Nurse Consultant II position.**

Subcommittee staff has raised no issues regarding this request.

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## **8. Placement of the Nursing Home Administrator Program within the DHS**

**Background and Governor's Proposed Budget:** Chapter 687, Statutes of 2001, among other things, (1) establishes a designated citation and administrative fine assessment system, (2) streamlines enforcement functions, , and (3) moves the Nursing Home Administrator Program and its operations from the Department of Consumer Affairs to the DHS.

**The budget proposes an increase of \$530,000 (Nursing Home Administrator Fund) and 5 positions to reflect the changes as contained in Chapter 687, Statutes of 2001.**

Subcommittee staff has raised no issues with this proposal.

## **9. East End Complex Adjustment—Budget Proposal and Finance Letter**

**Background and Governor's Proposed Budget:** The DHS has a legislative mandate to relocate headquarters staff and operations from multiple currently leased and state owned locations in downtown to the East End complex when construction is completed in April 2003. The DHS will be relocating about 3,700 employees into three buildings totaling 689,000 useable square feet.

**The budget requests an increase of \$6.775 million (\$2.9 million General Fund).** Of this amount: **(1)** \$277,000 is for one-time only moving and relocation costs, **(2)** \$1.9 million is for increased rent, **(3)** \$66,000 is for one-time only expenditures for furnishing and equipment, and \$4.5 million is for one-time only information and technology costs (consulting, network equipment, and data center services).

The DHS notes that denial of these resources would impede deployment and utilization of the capital outlay investment. If the buildings in question cannot be occupied, the DHS contends that there would be added cost to the state from the burden of overlapping construction bond debt service with continued costs of occupying current facilities (i.e., double rent).

**Finance Letter:** On March 29<sup>th</sup>, the Subcommittee received a Finance Letter to update the budget proposal. Specifically, the letter requests a **reduction of \$2 million** (General Fund) in equipment expenditures since these costs can be included in the long-term bond financing used to finance the overall project.

Subcommittee staff has raised on issues with this proposal.

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## **C. ITEMS FOR DISCUSSION**

### **1. Complaint Enforcement—Request for Staff**

**Background:** Since 1987, the **Licensing and Certification (L&C) Branch** within the DHS has **been charged with the responsibility to certify and re-certify** Certified Nursing Assistants (**CNAs**), Home Health Aides (**HHAs**), and Certified Hemodialysis Technicians (**HHAs**). CNAs and HHAs provide about 80 percent of direct patient care services in nursing homes and in the patients' home setting. **According to the DHS, there are about 114,000 CNAs, 36,000 HHAs, and 4,200 CHTs.**

**As part of this certification function, the L&C receives complaints regarding licensed or certified staff, investigates those complaints, and takes appropriate disciplinary actions such as placing the individual on probation, and suspending or revoking their license/certification.**

Complaints are received from various sources, including the facilities themselves, the long-term care Ombudsman, families, L&C district offices and law enforcement agencies. **The DHS states that about 590 complaints were filed and investigated in 2000.** Of these, 40 percent resulted in a disciplinary action against the licensee.

**Existing DHS Resources:** Currently, the L&C Enforcement/Complaint Unit has **9 positions, including one clerical support position.** **The DHS states that each investigator has an average of 94 cases in process.**

**Governor's Proposed Budget:** The budget is requesting **an increase of \$790,000 (\$395,000 General Fund) to fund 9 new positions—8 Health Facilities Evaluator II positions and one Program Technician II (clerical support) position.** **This request would double the number of existing staff.**

The DHS states that these additional resources are needed to meet anticipated workload. The DHS contends that the first 6 months of 2001 showed a markedly higher increase in complaints and that the volume is continuing to grow. For example, from January 2002 to March 21, 2002, the DHS states that they have received 517 new cases.

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following questions:

- **1. Please provide a brief summary of the request.**
- **2. Has the DHS ever considered having this Unit be fee supported?**

**Budget Issue:** Does the Subcommittee want to approve the budget proposal, or due to the existing budget situation, modify the request?

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## **2. Request for DHS Positions to Conduct AB 1075 Nursing Home Rates & Ratios**

**Background:** Chapter 684, Statutes of 2001 (AB 1075), among other things requires the DHS to do the following:

- Develop minimum staffing regulations that establish direct care staff-to-patient ratios at nursing homes by August 2003.
- Implement a facility specific Medi-Cal reimbursement system for nursing homes (both “freestanding” and Distinct-Part Nursing Facilities (DP-NF)) by August 2004.

**The changes in these staffing requirements and the rate system will result in significant additional workload for the DHS.**

**Governor’s Proposed Budget and Requested Staffing Needs:** The budget is requesting an increase of **\$5.3 million (\$2.7 million General Fund) to fund 55.5 new positions and to provide for certain consultant contract services. It should be noted that the funding level assumes all of the positions are hired by July 1, 2002.** The requested positions are outlined below.

- **Audits and Investigations (35 Positions):** A&I is requesting a total of 35 positions to audit facilities’ operating costs. **The DHS contends that in order to shift to a facility-specific rate system, A&I staff will need to (1) audit a greater percentage of nursing facilities on an annual basis, and (2) expand the level of detail covered in each audit to ensure costs are reported accurately relative to facility staffing levels. The requested positions include 28 Health Auditors, 5 Health Auditor Managers and two Office Technicians.**

The DHS assumes that **an additional 417 facilities will need to be audited each year in order to reach every facility within a three-year window.**

**A&I presently has 194 audit staff available for all program areas.** They contend that the current year workload for these staff equates to 201 full-time equivalents. As such, they maintain that there are no available resources to meet the new requirements.

- **Licensing and Certification Program (13.5 Positions):** L&C is requesting a total of 13.5 positions. The two main functions that these positions will be used for are to (1) verify patient acuity data (known as minimum data sets) obtained from the nursing homes and used to measure patient needs, and (2) verify nursing home compliance with the upcoming staffing ratios. **The requested positions for these activities are as follows:**
  - 11 positions-- one Health Facility Evaluator Manager, 9 Health Facility Evaluators and one System Analyst—for verifying the patient acuity data; and
  - 2.5 positions—1.5 Health Facility Evaluators and one Analyst (two-year limited-term)—for developing the staffing ratio regulations and verifying compliance with the staffing ratios.

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The DHS states that 11 positions for verifying the patient acuity data are needed in order **to verify one-third of the facilities each year** for the accuracy of the minimum data set submissions, to assess the integrity of the data and to work with the rate setting team on technical issues pertaining to the data sets. **They contend that this data is critical in the development of the facility-specific reimbursement system.**

- **Medical Care Services (5 Positions):** This section is requesting a total of 5 positions to (1) develop nursing facility rates, and (2) determine the effect of staffing ratios on rates. **The requested positions include three Research Analyst IIs, one Research Program Specialist II, and one Research Manager I.**

The DHS states that in order to conduct these functions many analytical activities must be conducted including (1) developing cost estimates based on the new nurse staffing requirements, (2) developing necessary adjustments in labor cost projections, and (3) refining the DHS' ability to collect and analyze data.

- **Office of Legal Services (2 Positions—Limited Term):** This office is requesting one Staff Counsel position (two-year limited-term) and an Analyst position (two-year limited-term) in order to provide legal support for new facility-specific rate development and develop staffing-ratio regulations. The DHS states that if timely legal advice is not provided then litigation may result.

**Recommendation of the Legislative Analyst's Office and Response from the DHS:** In her Analysis, the LAO recommends deleting a total of 11.5 positions from the requested 55 positions for a savings of \$672,000 (\$336,000 General Fund), and adoption of Budget Bill Language which requires that any unspent funds from the positions be reverted to the General Fund.

**The 11.5 positions recommended by the LAO for deletion include: (1) 1.5 Health Facility Evaluators, (2) three Research Analysts for rate development, (3) Five Auditors, (4) Two positions—Staff Counsel, and an Analyst—from the Office of Legal Services.**

**After review of the LAO proposal, the DHS has agreed to modify their request by deleting 6.5 positions (Health Facility Evaluators and the Auditors) for a reduction of \$499,000 (\$250,000 General Fund).**

**However the DHS maintains that they need the three Research Analyst positions and the two positions for the Office of Legal Services in order to meet the legislatively mandated time frames for rate and regulation development as contained in AB 1075.**

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following questions:

- 1. Please provide a **brief summary** of the proposal.
- 2. Please explain why the positions for rates and legal services are needed in the budget year.

**Budget Issue:** Does the Subcommittee want to approve or modify the budget proposal to provide the DHS with additional staff?

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### **3. Medi-Cal County Administration—Requests for Trailer Bill Legislation**

**Background and Budget Act of 2001:** Counties are responsible for conducting Medi-Cal eligibility processing and enrollment functions. The state provides funding (General Fund and federal funds) for this purpose **based on four general components:** (1) recent caseload data, (2) estimated policy changes that affect eligibility processing or related functions, (3) staff training and development, and (4) cost-of-doing business adjustments.

**Through the budget process, the state generally provides counties with cost-of-doing business adjustments. These adjustments are intended to account for such factors as (1) increases in the cost of goods and services (such as office supplies and janitorial services), (2) expenses related to information technology upgrades or replacements, (3) adjustments to salaries, and (4) increases in facility operation costs.**

Only twice during the recession years of the early 1990's did the state not provide an adjustment for the cost-of-doing business and this deletion was reflected in the final Budget Act.

In the Budget Act of 2001, the Legislature appropriated about \$107 million (total funds) as proposed by the Administration for the counties' cost-of-doing business adjustments. This funding level was sustained by the Governor. **However at the direction of the DOF, the DHS withheld the allocation of the funds to the counties.**

**This \$107 million (total funds) appropriation was then proposed for deletion on January 10, 2001 when the Governor's budget was released and the Medi-Cal estimate package was revised for the current year (2000-01). No formal notification from the Administration regarding this issue was received prior to this date.**

The Administration states that the cost-of-doing business adjustment should not have been included in the Budget Act of 2001 for the Medi-Cal Program because the Department of Social Services did not include a corresponding adjustment for this purpose in their budget. **However the Governor did not veto this item out, nor was the Legislature informed of the miscue at any time, until the release of the January change.**

**Constituency Request—Two Items:** The County Welfare Directors Association (CWDA) is requesting **adoption of trailer bill legislation which would require the Administration to notify the Legislature and counties** within 60-days of passage of the Budget Act if it plans to withhold and not allocate any of the local assistance appropriation for Medi-Cal Administration within the fiscal year.

**The CWDA contends this language is needed in order for counties to plan their budgets accordingly.** Finding out late in the year that there is no intention to allocate funds or portions of funds significantly impedes the counties ability to manage operations within the resources provided.

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The CWDA is also seeking a statutory change to provide the DHS with the authority to re-allocate unspent Medi-Cal administrative funds to counties that overspend their allocations. In an environment when the cost-of-doing business is not being funded, the CWDA believes that the DHS should have the authority to re-allocate unspent administrative funds based on the needs of the counties. **This language would enable the counties to utilize funding for critical eligibility services without exceeding the appropriation.**

The CWDA also notes that the Department of Social Services has used this approach for several of their programs for many years.

**Governor's Proposed Budget:** The budget to delete \$19.1 million (\$9.6 million General Fund) from county administration of the Medi-Cal Program by eliminating funds for standard cost-of-doing business adjustments. This reduction is in addition to a current year reduction of \$186.5 million (total funds) which was just proposed for elimination in the current year.

**Budget Issue (See Hand Out):** In addition to the budget proposal to reduce county administration by \$19.1 million (\$9.6 million General Fund), does the Subcommittee **want to adopt trailer bill legislation to (1)** require the Administration to provide notification if funds are not going to be allocated, and **(2)** provide the DHS with authority to re-allocate funds to counties that overspend their allocations?

#### **4. Medi-Cal Drug Program—Various Proposed Adjustments** **(ISSUES “A” Through “H”)**

**Overall Background on the Core Program:** Nationwide pharmaceutical costs are **the fastest growing component of all health care**. Generally, the growth is mainly due to technological advances in and cost of the development of new pharmaceutical products. Numerous states have recently enacted changes to their Medicaid Programs (Medi-Cal in California) in order to control costs.

California has historically had one of the least expensive Medicaid pharmaceutical programs in the nation. **The Medi-Cal fee-for-service Drug Program controls costs through two major components—(1) a Medi-Cal List of Contract Drugs (or formulary), and (2) contracts with almost 100 pharmaceutical manufacturers for supplemental rebates. Drugs listed on the formulary are available without prior authorization. In turn, the manufacturers agree to provide certain rebates mandated by both the federal and state government.**

**The state supplemental drug rebates** are negotiated by the DHS with manufacturers to provide additional drug rebates above the federal rebate levels. For the budget year, it is estimated that the state supplemental rebates will save \$265.4 million (\$132.7 million General Fund). **With respect to the federal rebates**, the budget assumes savings of \$769 million (\$372.6 million General Fund).

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According to the DHS, the fee-for-service pharmacy program services about 50 percent of the Medi-Cal eligible population. This half is mainly composed of Aged, Blind and Disabled individuals. **The budget estimates that \$3.8 billion will be needed for fee-for-service pharmacy benefits.**

**Background on DHS Activities:** The DHS administers the pharmacy program and is responsible for the following activities:

- Review of new drugs for inclusion in the Medi-Cal List of Contract Drugs;
- Screen drugs for safety, efficacy, essential need, misuse potential, and cost;
- Negotiate with manufacturers for rebates;
- Collect rebates and resolve rebates disputes; and
- Develop drug and medical supply policies.

The DHS **currently has 23.5 positions dedicated to the pharmacy program.** Of these existing positions, there are **(1)** twelve Pharmaceutical Consultant I/IIs, **(2)** 7.5 Analysts, **(3)** one Staff Services Manager II, **(4)** one Staff Services Manager, and **(5)** two support staff.

**Governor's Proposed Budget:** The budget proposes **a reduction of about \$200.8 million (\$100.4 million General fund) by enacting the following adjustments to selected areas of the Medi-Cal pharmacy program:**

Area of Adjustment	Total Savings	GF Savings
AIDS and Cancer Drugs—supplemental rebate	\$14.1 million	\$7 million
Aged Rebate Disputes	\$13.5 million	\$6.8 million
Generic Drug Contracting	\$53.4 million	\$26.7 million
Atypical Antipsychotics—conduct a therapeutic category review	\$29.5 million	\$14.8 million
Enteral Nutrition contracts	\$18.1 million	\$9.1 million
Enteral Nutrition rate reductions	\$21.3 million	\$10.6 million
Medical Supply contracting	\$17.9 million	\$9 million
Nonsteroidal—conduct a therapeutic category review	\$16.9 million	\$8.4 million
Duration of therapy audits	\$10 million	\$5 million
Frequency of billing audits	\$6 million	\$3 million
<b>TOTALS</b>	<b>\$200.7 million</b>	<b>\$100.4 million</b>

**Each of these proposals is discussed below.**

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## **ISSUE “A”—Aged Rebate Payment Dispute Resolution**

**Background and Governor’s Proposed Budget:** The DHS has the fiscal intermediary (currently EDS) **submit quarterly invoices to pharmaceutical manufacturers** reflecting the quantity of drugs reimbursed by Medi-Cal through the fee-for-service claims processing system. **The manufacturers then calculate the amount due based on the rebate agreements for each of their drugs, and remit the payment amount.**

When manufacturers disagree with the state invoices, they can dispute the amount of the rebate owed to the state. This places a portion of their payment on hold until the rebate dispute is resolved. Rebates resolved in favor of the DHS must be paid with interest costs.

**The DHS states that additional aged rebate payment disputes could be resolved resulting in added state rebate payments. Specifically, the budget assumes that additional savings of \$13.5 million (\$6.8 million General Fund) could be achieved.**

The DHS is presently developing a new rebate accounting and information system which is expected to make the payment dispute resolution process more efficient by 50 percent. **This new system, coupled with three additional staff (to be discussed under Item 5, below), is expected to achieve the savings level. The DHS assumes that each analyst can resolve an average of \$1.5 million General Fund in aged rebate disputes.**

**It should be noted that this proposal does *not* require any statutory changes.**

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following question:

- 1. Please provide a **brief description** of the proposal.

**Budget Issue:** Does the Subcommittee **want to adopt the proposed local assistance savings level as contained in the budget for resolving aged rebate payment disputes?**

## **ISSUE “B”— Frequency of Billing Audits & Duration of Therapy Audits**

**Background and Governor’s Proposed Budget:** The DHS employs two methods to decrease inappropriate drug utilization. Under the “**Frequency of Billing Limitations**” **the number of claims for the same drug and strength dispensed to the same Medi-Cal recipient is limited during a specified time period.** Many drugs on the Medi-Cal List of Contract Drugs have frequency limitations; however there is a need for ongoing review and assessment of the appropriateness of current limitations or the potential for new limitations.

Another method available is the “**Duration of Therapy**” audit which was re-instituted last year. Under this audit, a Medi-Cal recipient’s use of a specific drug is limited to a set period, after which prior authorization is required. The DHS states that this audit process

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forces some drug therapies into prior authorization review so that the appropriateness for chronic treatment can be accessed.

**The budget proposes local assistance savings of \$16 million (\$8 million General Fund) for these audits (\$5 million General Fund for the “Duration of Therapy” audits and \$3 million for the “Frequency of Billing” audits).**

**No statutory changes are needed to proceed with this proposal.**

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following question:

- 1. Please provide a **brief description** of the proposal.

**Budget Issue:** Does the Subcommittee want to adopt the budget proposal to save \$16 million (\$8 million General Fund) in local assistance by increasing these audits as proposed?

### **ISSUE “C”— Generic Rebate Contracting**

**Background and Governor’s Proposed Budget:** Currently 545 individual labelers (some manufacturers have more than one labeler code) have a federal Medicaid rebate contract. Some of these manufacturers produce only single-source or innovator multi-source drugs. **An innovator multi-source drug was the original single-source drug before generic drug introduction into the market. The remainder of the manufacturers produce only generic (multi-source) drugs.**

**DHS currently does not contract with generic drug manufacturers. However, Section 14105.33 of W& I Code does allow the DHS to enter into contracts with manufacturers of single-source and multiple-source drugs, on a bid or non-bid basis.** As such, DHS believes that this is an untapped source of cost reduction revenue within the Medi-Cal program.

According to the DHS, multi-source drugs account for about 20 percent of the state’s drug expenditures, or about \$763.6 million (total funds).

**The budget proposes savings of \$53.4 million (\$26.7 million General Fund) by contracting with manufacturers for rebates or prices lower than those provided under current federal cost limits. This assumes about a 7 percent rebate amount.**

**No statutory changes are needed to enact the proposal.** However, the DHS notes that California will need to obtain federal CMS exemption from the federal upper limit price aggregate reimbursement levels. Generally, federal regulations limit the amount which Medicaid reimburses for drugs with available generic drugs.

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**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following question:

- 1. Please provide a **brief description** of the proposal.
- 2. What is needed in order to obtain federal CMS exemption?

**Budget Issue:** Does the Subcommittee want to adopt the budget proposal to capture \$53.4 million (\$26.7 million General Fund) in local assistance savings?

**ISSUE “D”—Therapeutic Category Reviews for Nonsteroidal Anti-Inflammatory Drugs and Atypical Antipsychotics**

**Background and Therapeutic Category Review Process:** One method for the DHS to add drugs to the Medi-Cal formulary is to **conduct a therapeutic category review (TCR) to assess a group of drugs designed to treat a particular symptom.** Under the TCR process, the Medi-Cal Drug Advisory Committee evaluates the drugs within a category (such as nonsteroidal anti-inflammatory) using criteria including safety, effectiveness, essential need, cost and misuse potential. Based on this evaluation, the Committee makes recommendations to the DHS on which drugs should be included on the formulary.

The DHS then reviews the Committee’s recommendations, obtains input from the manufacturer’s of the drugs, reviews cost data, considers other sources of information such as clinical studies, and **then submits recommendations for TCRs to the Director of the DHS for a final determination. Drugs can then be added or deleted from the list of contract drugs accordingly.**

**Continuity of Care Provisions for Medi-Cal Recipients:** Within existing statute, there are several references for maintaining existing Medi-Cal recipient continuity of care. Generally, a Medi-Cal patient has the legal right to continue their existing course of treatment as long as it is medically necessary.

As noted in Section 14105.33 (i), **the department is required to provide individual notice to Medi-Cal recipients at least 60 calendar days prior to the effective date of the deletion or suspension of any drug from the list of contract drugs.** Further, the notice shall include a description of the fair hearing process and will encourage the recipient to consult with their physician to determine medication needs.

It should also be noted that any drug which is not part of the Medi-Cal formulary but is required by the patient as prescribed by a physician, can be obtained through the Treatment Authorization Request (TAR) process. **According to the DHS, the TAR turn around time for prescription medications is to respond by the next business day.**

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**Governor’s Proposed Budget:** The budget proposes savings of **(1) \$16.9 million (\$8.4 million General Fund)** to either renegotiate current contracts to increase the rebate obtained on nonsteroidal anti-inflammatory drugs, or possibly perform a review of the cost effectiveness of all drugs of this type through a TCR process, **and (2) savings of \$29.5 million (\$14.8 million General Fund)** for conducting a similar process for Atypical Antipsychotic drugs. No statutory changes are required for the DHS to implement this proposal.

The DHS states that Atypical Anti-psychotic drugs are a therapeutic category of drugs for which the Medi-Cal Program expends more than any other class of drugs. Specifically, about \$400 million is expended annually. The estimated budget savings assumes that the DHS obtains a **7.5 percent reduction** in costs through the negotiation process.

The Non-Steroidal Anti-Inflammatory Drug is also a category of drugs for which Medi-Cal expends a significant amount of funds. The estimated budget savings assumes that the DHS obtains a 10 percent reduction in costs through the negotiation process.

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following questions:

- **1. Please provide a brief description of the proposal.**
- **2. How can the DHS ensure Medi-Cal recipient access to drugs, particularly the Atypical Antipsychotics?**
- **3. Please briefly describe the TAR process for the receipt of medications.**
- **4. How many TCRs have been conducted by the DHS since its inception and have drugs ever been added to the formulary due to the TCR process?**

**Budget Issue:** Does the Subcommittee want to adopt the proposed budget to save a total of **\$46.4 million (\$23.2 million General Fund)** in local assistance through the use of a TCR for Nonsteroidal Anti-Inflammatory drugs and Atypical Antipsychotics?

### **ISSUE “E”—AIDS and Cancer Drugs Supplemental Rebates**

**Background: and:** Any drug approved for use in the treatment of Acquired Immune Deficiency Syndrome (AIDS) or an AIDS-related condition or for the treatment of cancer, is automatically added to the Medi-Cal List of Contract Drugs as required by existing statute. **This automatic addition bypasses the standard Medi-Cal contracting process. As such, Medi-Cal only receives the federally mandated rebates for these products (about a 20 percent rebate), not any state supplemental rebates.**

Currently, expenditures for **AIDS and Cancer drugs are about \$162 million** in the Medi-Cal Program.

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The DHS states that on average, contracting for state supplemental rebates would return an additional 6 to 10 percent. However, since existing statute mandates the automatic addition of these products to the List of Contract Drugs, the DHS contends that a state supplemental rebate must be mandated through legislation.

**Governor's Proposed Budget (See Hand Outs):** The budget proposes savings of \$14.1 million (\$7 million General Fund) by requiring a 10 percent state supplemental rebate on AIDS and Cancer drugs.

The Administration proposes trailer bill language to (1) require the 10 percent state supplemental rebate level from these manufacturers, (2) give the DHS authority to suspend all drug products of any manufacturer that fails to contract for the rebates, and (3) provide certain Medi-Cal recipient protections in the event that a drug is suspended from the List of Contract Drugs.

**Constituency Concerns:** Some manufacturers have expressed concern regarding the wording in the proposed trailer bill language as it pertains to the "10 percent" state supplemental rebate amount. **In lieu of a percentage designation, they would prefer alternative language which (1) does not make reference to a particular percentage level, (2) re-crafts the ability of the DHS to delete the manufacturers other drug products from the formulary, and (3) establishes a two-year sunset on the state supplemental rebate requirement.**

It should be noted that the Administration's proposed budgeted savings amount of \$14.1 million (\$7 million General Fund) is not being opposed, only the language as currently crafted.

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following questions:

- 1. Please provide a **brief description** of the proposal, including the proposed trailer bill language.
- 2. How will the DHS **ensure access to AIDS and Cancer drugs for Medi-Cal recipients?**

**Budget Issue:** Does the Subcommittee **want to adopt or modify the proposed budget to save \$14.1 million (\$7 million General Fund)?**

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## **ISSUE “F”—Medical Supply Contracting -- Blood Glucose Strips**

**Background and Governor’s Proposed Budget:** Federal law classifies medical supplies as a Medicaid (Medi-Cal) optional benefit. **State law lists medical supplies as a benefit, sets the reimbursement rate, and allows the state to enter into contract agreements with these manufacturers and distributors.**

**According to the DHS, medical supply claims have risen to become about 13 percent of the drug/medical supply item with expenditures of more than \$200 million annually. Other than with incontinence supplies, the DHS does not contract with medical supply manufacturers.**

Contracting for medical supplies requires that the individual supply items be easily identifiable by manufacturer and product. **The Universal Product Number (UPN) is an essential part of that identification. Since the development of the UPN requires significant claim processing system changes, the DHS proposes to start with medical supplies that can currently be identified using a UPN. Blood Glucose test-strips are such a product. The state spends about \$56 million annually on these strips.**

**The budget proposes a reduction of \$17.9 (\$9 million General Fund), or a reduction of about 32 percent, by contracting for Blood Glucose test-strips. The DHS states that this is based on discussions with manufacturers of the test-strips regarding their current level of contracting with other purchasers.**

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following question:

- **1. Please provide a brief description of the proposal.**

**Budget Issue:** Does the Subcommittee want to adopt the budget proposal to save \$17.9 million (\$9 million General Fund)?

## **ISSUE “G”—Enteral Nutrition Contracts and Rate Reductions**

**Background and Governor’s Proposed Budget (See Hand Out):** The DHS currently does not contract with manufacturers for rebates on enteral nutrition products. In order to reduce expenditures for these products, the DHS intends to establish a list of approved nutritional products and **contract with selected manufacturers for discounts or rebates.**

**In addition, the current reimbursement rate for nutritional products is higher than the DHS believes to be required to maintain access to these products. As such, the Administration is proposing to change the reimbursement of these products from a “mark-up” based on an estimated acquisition cost to a flat dispensing fee.**

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From these two actions, the budget assumes savings of \$39.4 million (\$19.7 million General Fund) in local assistance.

Both of these proposals require state statutory changes. Specifically, statutory changes are required to: (1) allow the DHS to create a list of contract medical foods and dietary supplements, (2) allow the DHS at their option to declare those nutritional products not on the list to be non-benefits of the program, (3) provide discretion to the DHS to review additional products for inclusion on the list in future years, and (4) enable the DHS to alter the pharmacy reimbursement methodology for nutritional products.

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following question:

- 1. Please provide a **brief description** of the proposal.

**Budget Issue:** Does the Subcommittee want to adopt or modify the budget proposal to save \$39.4 million (\$19.7 million General Fund) as proposed?

#### **ISSUE “H”—Other Proposed Trailer Bill Changes to the Medi-Cal Drug Program**

**Governor’s Proposed Budget:** In addition to the items outlined above, the budget proposes changes in trailer bill legislation as follows:

- **1. Eliminates the Sunset Date for the Medi-Cal Drug Program:** The overall Medi-Cal Drug Program is slated to sunset as of **January 1, 2003**. **The Administration is proposing to eliminate the sunset date in order to continue the program indefinitely.** Historically, the sunset date has been extended in two-year increments through budget trailer legislation since 1992. These two-year extension periods have occurred at the request of constituency groups who have desired the opportunity to revisit the program if problems arose regarding the administration of the statute and program.

The Administration contends that the Medi-Cal Drug Program is an integral component to the overall Medi-Cal Program and should be permanently established.

- **2. Drugs with Therapeutic Gain:** The Administration is **proposing to delete existing statute** (i.e., Section 14105.39 (c)) which generally provides that any new drug designated as having an important therapeutic gain and approved by the FDA shall immediately be included on the list of contract drugs for a period of three years if certain conditions are met.

**The DHS contends this language is obsolete and needs to be deleted because of federal law changes that occurred in 1992.** In 1992, the federal FDA discontinued the practice of labeling drugs as having an “important therapeutic gain” and instead,

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began using the designations of “P” (for priority) or “S” (for standard). **However, state law has never been updated to reflect these federal changes.**

**As such, the DHS states that retaining this obsolete language has caused controversy among a few manufacturers regarding the automatic inclusion of new drugs on the Medi-Cal formulary. Therefore, the Administration believes the language needs to be deleted or it will have a detrimental affect on the budget.** Specifically the Administration is concerned that if the provision is maintained litigation may ensue which **could result in a loss of state supplemental drug rebate revenues or could require the DHS to promulgate regulations to identify which new drugs have an “important therapeutic gain”.**

**Further, the DHS notes it gives first priority to reviewing manufacturer’s requests to be added to the Medi-Cal List of Contract Drugs for “P” drugs.** It should also be noted that all federal FDA approved drugs are available to Medi-Cal recipients via the prior authorization process if the drug is not on the list of contract drugs.

**Opponents of the proposal maintain that though changes are needed to this section of statute, policy legislation should be used as the vehicle to more thoroughly craft a comprehensive solution instead of just deleting the provision.**

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following questions.

- **1.** Please explain why the Administration is seeking to delete Section 14105 (c) from existing statute and why this may have budget implications.

**Budget Issue:** Does the Subcommittee want to adopt or modify the proposed trailer bill language?

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## 5. **DHS Request for Staff to Implement Medi-Cal Drug Program Changes**

**Background:** The DHS currently has **23.5 positions dedicated to the pharmacy program**. Of these existing positions, there are **(1)** twelve Pharmaceutical Consultant I/IIs, **(2)** 7.5 Analysts, **(3)** one Staff Services Manager II, **(4)** one Staff Services Manager, and **(5)** two support staff. **Generally, this staff does the following:**

- Reviews of new drugs for inclusion in the Medi-Cal List of Contract Drugs;
- Screens drugs for safety, efficacy, essential need, misuse potential, and cost;
- Negotiates with manufacturers for rebates;
- Collects rebates and resolve rebates disputes; and
- Develops drug and medical supply policies.

**Governor's Proposed Budget:** In order to achieve savings of \$100.4 million (General Fund) in local assistance as discussed above in item 4, **the DHS contends it needs 16 new state positions, plus funds for 4 Pharmaceutical Consultant II positions to be hired through contractual arrangements.**

**The budget proposes expenditures of almost \$1.4 million (\$483,000 General Fund) for the state positions, and an additional \$640,000 (\$160,000 General Fund) for the proposed contract staff. The proposed positions are as follows:**

- 10 Pharmaceutical Consultant II **(including 4 contract staff) (PC II)**
- 2 Pharmaceutical Program Consultants **(PPC)**
- 1 Staff Services Manager II **(SSM II)**
- 1 Staff Services Manager I **(SSM I)**
- 1 Nurse Consultant II **(NC II)**
- 4 Associate Governmental Program Analysts **(Analyst)**
- 1 Office Technician **(OT)**

<b>Area of Adjustment</b>	<b>Requested Positions</b>	<b>GF Savings</b>
AIDS and Cancer Drugs—supplemental rebate	1 PC II plus contract staff	\$7 million
Aged Rebate Disputes	3 analysts and OT	\$6.8 million
Generic Drug Contracting	5 PC II's plus contract staff	\$26.7 million
Atypical Antipsychotics—conduct a therapeutic category review	1 PC II	\$14.8 million
Enteral Nutrition contracts	1 PC	\$9.1 million
Enteral Nutrition rate reductions	(same as above)	\$10.6 million
Medical Supply contracting	NC II	\$9 million
Nonsteroidal—conduct a therapeutic category review	1 PC	\$8.4 million
Duration of therapy audits	1 analyst & 1 PC II	\$5 million
Frequency of billing audits	(same as above)	\$3 million
Overall supervision and monitoring	SSM I and SSM II	
<b>TOTALS</b>		<b>\$100.4 million</b>

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It should be noted that the pharmacist positions and the Nurse Consultant position are eligible for enhanced federal funding of 75 percent.

**In addition, the DHS is proposing trailer bill language to enable them to contract for pharmacists directly or through the fiscal intermediary (currently EDS).**

**Legislative Analyst Office Comment:** In her Analysis, the LAO recommends for the Legislature **to modify the budget proposal to provide for higher-level pharmacists positions.** She notes that the maximum amount for a DHS pharmacist salary is \$6,323 per month, while the private sector offers entry level individuals about \$8,000 per month in addition to signing bonuses. **Therefore, in order to attract pharmacists, the LAO recommends for the DHS to consult with the Department of Personnel Administration to establish a higher-level position that offers a more attractive salary to fill the requested positions.**

Since the state can receive an enhanced federal match (i.e., 75 percent) for pharmacist positions, there would be minimal General Fund expenditure.

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following questions:

- 1. Please provide a **brief overview** of the request.
- 2. What actions will the DHS be taking to fill existing pharmacist positions?

**Budget Issue:** Does the Subcommittee **want to adopt or modify the budget request?**

## **6. County Medical Services Program (CMSP)—ISSUES “A” and “B”**

**Overall Background:** The County Medical Services Program (CMSP) provides medical and dental care to low-income “medically indigent” **adults who reside in small counties (total of 34 counties)** (populations of 300,000 or less, with a few exceptions). The responsibility for providing these services was transferred from the state to the counties as of January 1, 1983.

**The CMSP Governing Board is responsible for the administration of pooled funds (mainly County Realignment, county participation fees, state General Fund and Proposition 99 funds) from the participating counties to provide services to over 60,000 CMSP participants.**

**Program Sunset Date:** The statute (Section 16809 of W&I Code) that establishes the CMSP is scheduled **to sunset as of January 1, 2003 unless it is extended in statute.**

**Preliminary Fund Condition Statement:** Revenues to support the CMSP come from several somewhat volatile sources, including County Realignment Funds (i.e., sales tax, vehicle license fees, and growth account), Proposition 99 Funds (selected accounts), and

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the General Fund (on deferral for the past 3 years). In addition, expenditures can vary considerably contingent upon fluctuating enrollment levels and health care needs.

**Based on preliminary information, it appears that the CMSP has a fund balance of \$107 million as of the current year.** However, within this fund balance, there is a need to maintain a provider claims reserve of \$46 million. This claims reserve excludes any reserve for litigation or caseload increases. **According to the CMSP Governing Board, the program expends about \$20 million per month.**

#### **ISSUE “A”—Proposed Elimination of the \$20 million in General Fund**

**Background and Budget Proposal:** As referenced above, the state capped its participation in the local assistance portion of the CMSP at \$20 million General Fund in 1993 as part of an overall agreement with the counties.

Since 1999 the Administration has proposed to permanently eliminate this funding commitment. **However the Legislature has repeatedly rejected this proposal for permanent elimination and has instead, agreed to simply defer the \$20 million since the funds have not been needed to support CMSP expenditures.**

**Governor’s Proposed Budget:** The budget proposes trailer bill language to (1) eliminate the \$20 million in General Fund support for the CMSP for the 2002-03 only, and (2) continuously appropriate the CMSP Account (i.e., fund) without regard to fiscal years. The budget also assumes deletion of the \$20 million (General Fund) for the budget year.

It should be noted that the Administration does not propose to extend the sunset of the program.

**Constituency Request:** The CMSP Governing Board is requesting for the Subcommittee to (1) extend the \$20 million (General Fund) deferral for one-year only, and (2) provide for a five year extension of the sunset.

**Budget Issue:** Does the Subcommittee **want to adopt the Administration’s proposal to defer for one more year the \$20 million General Fund commitment *and* provide for continuous appropriation of the CMSP Account? In addition, does the Subcommittee want to extend the sunset for the program by an additional five years?**

**Subcommittee Request and Question:** The Subcommittee has requested the DHS to respond to the following question.

- 1. Please provide a brief summary of the request, as it pertains to the \$20 million deferral and proposed trailer bill language.

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## **ISSUE “B”—Administration’s Proposal to Charge CMSP for Support**

**Background:** As required through existing state statute, the DHS provides administrative support to the program, including payment of reimbursement to providers for CMSP services, program data analysis, fiscal analysis and related support. This arrangement was part of an overall agreement that was made in 1993-94 when the state required the counties to be at risk for overall program expenditures. Specifically, the state capped the General Fund amount it was willing to provide at \$20 million with the understanding that the state would provide administrative support to the program.

**Governor’s Budget Proposal:** The budget proposes to delete \$5 million in General Fund support and to amend Section 16809 of the Welfare and Institutions Code to require the CMSP Board to reimburse the state for administrative services provided by the DHS. Their proposed language amendment is as follows:

- (a)  
(3) The contract between the department and the County Medical Services Program Governing Board shall require that the state maintain at least the level of administrative support provided to the County Medical Services Program for the 1993-94 fiscal year. County Medical Services Program Governing Board fully reimburse the State for all State costs of providing administrative support to the County Medical Services Program. ~~The department may decline to implement decisions made by the governing board that would require a greater level of administrative support than that for the 1993-94 fiscal year. The department may implement decisions upon compensation by the governing board to cover that increased level of support.~~

**It should be noted that the language as crafted is completely wide open for the Administration to charge the counties for any expenditures, valid or not.**

The Administration first proposed this change in the May Revision last year during budget deliberations for the Budget Act of 2001. **The proposal was rejected by both houses and it was never raised during the Conference Committee discussions.**

**DHS CMSP Estimated Administrative Cost Document (See Hand Out):** On March 25<sup>th</sup>, the DHS released a 20-page document in which they estimate the annual administrative costs for the CMSP.

Several items can be noted from this document. **First, the DHS identified costs only account for about \$3.6 million in General Fund expenditures, not the \$5 million identified for budget purposes. The DHS notes that a total of \$5.2 million in estimated CMSP expenditures has been identified but that about \$1.6 million of this amount was *inappropriately* claimed for federal reimbursement.**

**Second, about \$1.2 million is for fiscal intermediary claims processing costs (including both EDS and Delta Dental).**

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**Third, there are four remaining primary cost areas—(1) Medi-Cal Operations at \$1.6 million, (2) CMSP program staff at \$1 million, (3) Medi-Cal pharmacy operations at \$426,000, and (4) Audits and Investigations at \$366,000. The remaining costs, with the exception of about \$8,000 in CMSP Board travel expenditures, are spread throughout several areas of the DHS operations.**

**Further, it should be considered that given an opportunity, the CMSP Governing Board may choose to opt for a different arrangement than to have the DHS provide administrative support functions. It is possible that the CMSP may choose to utilize consultant staff, hire their own staff, or craft some other arrangement.**

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS, and Mr. Lee Kemper, Administrative Officer of the CMSP Governing Board, to respond to the following questions:

- **1. DHS,** Please provide **a brief summary** of the proposal.
- **2. DHS,** What needs to be done to address the federal fund claiming issue?
- **3. Mr. Kemper,** What is the CMSP Governing Board's perspective of the proposal?
- **4. Mr. Kemper,** What actions is the Board pursuing to reduce expenditures?

**Budget Issue:** Does the Subcommittee **want to adopt or modify the budget proposal?**

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## **7. Hospital Outpatient Services Settlement Agreement--Adjustment**

**Background—Hospital Outpatient Services:** Hospital outpatient services are those services described in Section 51113 of Title 22 of the California Code of Regulations. Generally these services include (1) Medi-Cal covered California Children Services, (2) Medi-Cal covered Comprehensive Perinatal Services, (3) Medi-Cal covered Child Health and Disability Prevention Program services, and (4) Medi-Cal covered Early and Periodic Screening, Diagnostic and Treatment Services. For example, this would include occupational therapy, speech therapy, physical therapy, audiology, psychology, laboratory, radiology, pharmaceuticals, and use of the facilities.

**Background—Settlement Agreement:** There were five lawsuits filed in federal and state court challenging the validity of Medi-Cal reimbursement rates for hospital outpatient services from March 1, 1987 through June 30, 2005. Generally, the plaintiffs in these lawsuits contended that the Medi-Cal rates violated federal law which requires payment to be "consistent with efficiency, economy, and quality of care" and sufficient to assure adequate access. **After years of litigation a Settlement Agreement was reached last year between the state and plaintiffs, though the required federal CMS approval is still pending.**

**Generally, the Settlement Agreement contained the following key provisions:**

- Provide a 30 percent rate increase as of July 1, 2001 (in the Budget Act of 2001);
- Grant annual rate increases of 3.33 percent for the next three years thereafter (effective July 1, 2002, 2003 and 2004); and
- Provide a \$350 million (\$175 million General Fund) lump sum payment to address prior years' low reimbursement levels (in the Budget Act of 2001).

It should be noted that since the federal CMS has not yet approved the lump sum payment provision, federal matching funds for this provision of the Settlement are not yet secured.

**Subcommittee Request and Question:** The Subcommittee has requested the DHS to respond to the following question:

- **1. What is the status of federal CMS approval regarding the lump sum payment portion of the Settlement Agreement and what are the next steps?**

**Governor's Proposed Budget:** The budget **proposes an increase of \$183.1 million (\$91.5 million General Fund) to provide a 3.33 percent rate increase for hospital outpatient services, effective July 1, 2002.**

**Budget Issue:** Does the Subcommittee want to approve the proposal?

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## **8. Disproportionate Share Hospital Program—"State Administrative Fee"**

**Background--DSH:** SB 855, Statutes of 1991, established the Medi-Cal Disproportionate Share Hospital (DSH) Payment Program **to maximize federal funds and provide special payments to eligible hospitals which serve a disproportionate share of Medi-Cal and uninsured patients.**

Funds obtained from public hospitals are transferred to the state (i.e., "Intergovernmental Transfer Funds) and used to obtain a federal match. **These funds are then allocated to eligible hospitals, including private hospitals who are restricted by federal law to providing any transfer funds, for expenditure (\$1.815 billion total funds for 2002-03).** These funds are intended to compensate hospitals for the vital services they offer as "safety net" providers.

**Background—State "Administrative Fee":** Prior to obtaining the federal match, the state acquires over \$29.7 million from the Intergovernmental Transfer Fund for expenditure in the Medi-Cal Program. **The \$29.7 million transferred to the state is used to off-set General Fund dollars.** From the hospitals perspective, the effect of the "state fee" is to reduce the financial benefit of the DSH Program to eligible hospitals.

**This "state fee" process began at the direction of Governor Wilson** during the early years of the state's fiscal crisis and was intended to be a short-term solution for addressing the General Fund deficiency problem. **At its height in 1995, a total of \$239.7 million was transferred to the state to provide a General Fund backfill.**

Since this time, the Legislature has worked to reduce the "state fee" and return the funds to the hospitals. **The Budget Acts of 1996, 1997, 1998, 1999 and 2000 have all reduced the fee by a total of about \$209 million over the five year period.**

**Governor's Budget Proposal:** The budget **proposes to increase by \$55.2 million** (from the existing \$29.8 million to a **total of \$85 million**) the amount transferred to the Medi-Cal Program. **The Administration states that this transfer is necessary due to the short-term fiscal shortfall.**

**Constituency Request:** A coalition of hospitals **is requesting the Subcommittee to oppose any increase in the "state fee".** They state that any increase in the "state fee" will serve to destabilize the DSH program and will likely generate increased federal scrutiny of the Medi-Cal Program. **In addition, the coalition contends that hospitals are losing ground financially for several key reasons as follows:**

- **DHS "Cliff":** Recent federal law changes have reduced federal Disproportionate Share Hospital (DSH) funds to be received by the state from about \$2 billion in the current year to an estimated \$1.815 billion, or **a reduction of \$184 million in the budget year.** As such, hospital groups are seeking federal law changes.
- **Upper Payment Limit:** Recent federal law changes and federal CMS regulatory changes will reduce the hospital upper payment limit from 150 percent to 100 percent for public hospitals. Once the final regulations are fully implemented, California could lose as much as \$300 million annually. As such, hospital groups are seeking federal law changes.

**Budget Issues:** Does the Subcommittee want to approve or modify the budget proposal?

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## **9. Graduate Medical Education (GME)—Extension of Sunset**

**Background:** Within the Medi-Cal Program, funds (intergovernmental transfer funds matched with federal Title XIX funds) are provided to teaching hospitals to support graduate medical education needs. About 26 hospitals currently receive these supplemental funds, including Children's Hospitals, major non-university hospitals and University of California hospitals. These funds are used for graduate students enrolled in medicine, nursing, public health, pharmacy, dentistry, and optometry.

It should be noted that the federal funds used to match the intergovernmental transfer funds maybe at risk due to the need for the state to obtain federal CMS approval of the Waiver used to operate the Selective Provider Contracting Program (under which the California Medical Assistance Commission contracts with hospitals for inpatient services). **However, it should also be noted that allocation of the GME funds by CMAC is discretionary. If funds are not available, an allocation does not need to occur.**

**The existing statute sunsets as of June 30, 2002.**

**Governor's Proposed Budget:** The budget proposes (1) expenditures of \$77.4 million (federal funds) which will be obtained using the intergovernmental transfer funds, and (2) proposes **to extend the statute which established the program by one-year.**

**Constituency Request:** The Subcommittee has received several letters representing hospital organizations, including the UC system, requesting **a two-year extension** to the sunset (i.e., to June 2004).

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following question:

- 1. Why is the DHS proposing to extend the statute for only one-year?

**Budget Issue:** Does the Subcommittee **want to extend the sunset date for one or two years?**

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## **10. Proposed Changes to the Medi-Cal Copayments**

**Background:** Existing state statute allows providers to collect copays for certain services. **Currently, there are three services subject to copayment**—outpatient services (\$1), drug prescriptions (\$1), and non-emergency services provided in an emergency room (\$5). **These collections are in addition to the existing Medi-Cal reimbursement rate, but collection is optional**

**Existing law exempts certain individuals from any copayment requirement**, including any person **18 years old and under**, any women receiving perinatal care or family planning services, anyone receiving emergency services or inpatient care, and any children 21 years or under who are living in board and care homes or institutions. **These exemptions would remain intact under the Administration’s proposal.**

**Federal law prohibits providers from refusing to provide services due to an individual’s inability to pay a copayment.**

**Governor’s Budget Proposal (See Hand Out):** The budget **proposes savings of \$61.2 million (\$30.6 million General Fund) by modifying the Medi-Cal recipient copayment statute. Under the proposal, the Administration would increase certain copayment amounts and reduce provider rates by the amount of the copayments.** It would be incumbent upon the providers to bill recipients and collect the money in order to make up the difference.

Medi-Cal recipients would have to pay from \$1 to \$5, contingent upon the health care service. For example, any physician service would require a \$2 copayment, while a hospital outpatient service would require a \$5 copayment. *(Please see the Hand Out for a listing of the proposed copayment amounts.)*

**The majority of the identified savings are assumed to come from four Medi-Cal service categories—prescription drugs, dental services, physician services and home health services.**

**Subcommittee Staff Comments:** Since federal law prohibits providers from refusing to provide services due to an individual’s inability to pay a copayment, the Administration’s proposal in practice will serve as a provider rate reduction. As such, some providers may further limit their participation in Medi-Cal.

In addition, some recipients may defer medical treatment due to the increased copayment amount and potentially become sicker.

**Budget Issue:** Does the Subcommittee want to adopt or modify the proposal?

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## **11. Proposed Provider Rate Reduction (See Hand Outs)**

**Background:** Prior to 1997, rates in the Medi-Cal Program had not been increased since 1986. Since this time, through the leadership of the Senate, several targeted increases have been provided, including the following:

- Increased the rates paid for emergency room physicians (1997).
- Increased the rates paid for primary and preventive services provided by physicians to children and adults.
- Updated the relative value scale for certain procedures provided to children by physicians (1998).
- Increased the rates paid for Early Periodic Screening Diagnostic and Treatment (1998).
- Increased the rates paid for procedures conducted under the CCS Program (1999).
- Increased the rates paid for ambulance services (1998 and 1999).
- Adopted several nursing home rate adjustments (1997, 1998, 1999, 2000, 2001)
- Augmented the rates paid for tubal ligations (1999).
- Restored the 9.5 percent rate adjustment for anesthesia, surgery and radiology (1999).

**In the Budget Act of 2000, most services provided under Medi-Cal received rate adjustments (See Hand Out). These adjustments were allocated across the CPT codes based on discussions between the DHS and various provider organizations and representatives.**

**Governor's Proposed Budget (See Hand Out):** The budget proposes a reduction of \$155.1 million (\$77.5 million General Fund) in provider rates.

**The proposed rate reduction is not derived from any across-the-board percentage amount, but instead, is driven by a dollar reduction amount the Administration wants to achieve. In essence, the dollar figure generally represents about half of the dollar increase provided via the Budget Act of 2000.**

**The DHS has convened several work groups to discern how to apply the reductions. The Administration assures that no service category will have their rate reduced below their 1999-2000 Medi-Cal reimbursement level.**

**The proposed rate reduction is intended to target services provided to adults, not children or services provided in long-term care facilities. To this end, the Administration is proposing uncodified trailer bill language as follows:**

“In implementing the Budget Act of 2002, if it is necessary for the Director of Health Services to reduce non-institutional provider services rates pursuant to the rate setting authority of subdivision (a) of Section 14105 of the Welfare and Institutions Code, the director shall, to the extent practicable, minimize the impact of those rate reductions on payments for services to persons under 18 years of age. Notwithstanding subdivision (a) of Section 14105 of the Welfare and Institutions Code, rate reductions applicable to Medi-Cal services and contracting related to the Budget Act of 2002 shall be effective July 1, 2002.”

The service categories that would be affected include physicians, dental, psychologists, home health, non-emergency transportation, chiropractic, respiratory, shift nursing, comprehensive perinatal services, audiology, and physical, occupational and speech

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therapies. **Based upon the volume of services provided, physician services would be most affected.**

**Constituency Group Concerns and Legislative Analyst Comment:** The Subcommittee is in receipt of letters from constituency groups expressing concerns regarding their economic viability to continue to provide services to Medi-Cal patients if the rates are reduced. They note that the rates are already considerable lower than what is paid in the Medicare Program and in private practice.

The Legislative Analyst Office has also expressed concerns regarding access to care if rates are reduced.

**Subcommittee Request and Questions:** The Subcommittee has requested the DHS to respond to the following questions.

- **1. Please briefly describe the proposal.**
- **2. Is the Administration rate reduction proposal intended to be limited-term?**
- **3. Specifically, how will the Administration ensure that childrens services (those for years 18 and under) are not affected?**
- **4. Please provide an update on the status and results-to-date of the work group process. What are the next steps?**